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SOCIAL, HUMANITARIAN AND HUMAN RIGHTS QUESTIONS: REPORTS OF SUBSIDIARY BODIES, CONFERENCES AND RELATED QUESTIONS: NARCOTIC DRUGS

Note verbale dated 28 March 1995 from the Permanent Mission of Colombia to the United Nations Office at Geneva addressed to the Director-General of the United Nations Office at Geneva

The Permanent Mission of the Republic of Colombia to the United Nations Office at Geneva and the other international organizations based at Geneva presents its compliments to the Office of the Director-General, United Nations Office at Geneva and has the honour to transmit herewith the document prepared by the Colombian Ministry of Finance and Public Credit, containing its comments on a report, "Colombian Economic Reform: The Impact on Drug Money Laundering within the Colombian Economy", prepared by the Drug Enforcement Administration (DEA) of the United States of America, contained in the annex.

The Colombian Mission requests that this document be distributed as an official document of the Economic and Social Council, under agenda item 5 (h).

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Annex

COMMENTS BY COLOMBIAN FINANCIAL AUTHORITIES ON THE REPORT "COLOMBIAN ECONOMIC REFORM: THE IMPACT ON DRUG MONEY LAUNDERING WITHIN THE COLOMBIAN ECONOMY", PUBLISHED BY THE INTELLIGENCE DIVISION OF THE UNITED STATES DRUG ENFORCEMENT ADMINISTRATION

(Santafé de Bogotá, D.C., 21 November 1994)

The report circulated by the United States Drug Enforcement Administration (DEA) reveals a profound ignorance of how the Colombian economy operates. Without any empirical or sound theoretical support, it tries to explain the behaviour of the country's economic variables as the result of cash flows coming from drug trafficking. Due to its lack of methodology or scientific accuracy and to its bias against the country, the report constitutes not only an insult to Colombians but an insult to intelligence.

In addition, the DEA report makes a serious criticism of Colombian reforms towards the opening of the economy, arguing that the new policies, which have resulted in a more modern and open trade system, more efficient foreign-exchange operations, integration with Venezuela and a greater role for the private sector in the economy (particularly in the financial sector and through the privatization of maritime ports), have benefited drug trafficking and have hampered the control of money laundering. Thus, contrary to many statements made by other United States agencies and by the Government of the United States of America, the DEA expresses its preference for a heavily nationalized economy with very little space for the private sector. This preference, of course, is far from being shared by the Government of Colombia.

The present document contains comments on the DEA report and is divided into four sections. The first section refers to the macroeconomic issues discussed in the DEA report and the effects of the liberalization of the foreign-exchange market. The second section focuses on DEA commentaries on the financial reform and privatization process. The third section refers to DEA coverage of the commercial liberalization process, economic integration with Venezuela and the privatization of maritime ports. The fourth and final section contains a number of concluding statements.

Some elements of the DEA report are not explicitly addressed in the present document, due to their gratuitous character. A typical example is the statement that the cities of Barranquilla, Cali and Medellín are economically dependent on the drug-trafficking industry. The development of those cities throughout this century has been quite independent from such phenomena. In fact, drug trafficking has had negative side-effects - in terms of violence, international discredit etc. - that have disrupted those cities' normal development.

I. MACROECONOMIC ISSUES

Contrary to what is stated in the DEA report, there is no basis whatsoever for explaining the large cash inflows that have taken place since 1990 solely in terms of the drug economy. For the same reason, the explanation in the report that characterizes the recent revaluation process of the Colombian peso as a result of cash inflows from drug-trafficking activities is hasty, to say the least.

Any well-informed analyst of Colombian affairs knows that, as was the case in all medium-sized and large Latin American countries in the 1980s, due to the debt crisis and also in response to rising interest rates in the United States of America, there was significant capital flight from Colombia. In the 1990s, this tendency was dramatically reversed, generating a massive capital inflow that was independent of drug-trafficking activities.

A. Capital flows

Capital inflows into Colombia as of the beginning of the 1990s are the result of exogenous factors, which are sufficiently illustrated in such works as Capital Inflows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors. a/ The generalization of the capital inflow process into developing countries and in particular into Latin America finds its explanation in low international interest rates, recession in the industrialized countries and confidence in sound macroeconomic programmes.

In the case of Colombia, as well as other Latin American countries, such factors have also been joined by modifications in foreign-exchange regimes and a greater spread between domestic and external interest rates generated mainly by expectations of exchange-rate revaluation, which tend to validate themselves as a result of those same capital inflows.

Controls prevailing prior to foreign-exchange reforms did not prevent the inflow of dollars for personal services, tourism and transfers, or address the problems of inadequate valuation of trade goods. Nor did they prevent capital flight when macroeconomic conditions generated incentives in that direction.

The 1991 foreign-exchange reforms liberalized the market, suppressed inoperative controls and, together with fiscal cleaning-up measures, enabled the legalization of Colombian capital that had previously been invested abroad: such capital was abroad because of the former exchange-control system and not because it came from illicit businesses. The purpose of the foreign-exchange reforms was to liberate the economy and integrate financial markets with the rest of the world (the new regulations authorized properties and bank accounts, as well as investments in assets and settlement of accounts abroad). Contrary to what the DEA report suggests, the Banco de la República, the Central Bank of Colombia, had previously centralized all foreign-currency purchases.

It must be understood that the liberalization of the foreign-exchange market did not eliminate the requirement to register foreign-exchange operations (whether of trade in goods and services or financial transactions): the

principal responsible for them, their amounts and their conditions must all be registered. At present, any foreign-exchange operation must be carried out through authorized financial institutions and foreign-exchange offices (the latter for some operations only).

The liberalization of the foreign-exchange market, as mentioned above, has not contributed to money laundering. The process did not involve absolute liberalization and it retains certain regulations. Indeed, the reform developed two types of markets: a free one and a regulated one, placing in the latter those operations of greater significance to national accounts in terms of not only their nature but also the amount of money involved. In this way, control was retained in the Central Bank.

Regarding the free-exchange market, that system was designed in order to delegate control to foreign-exchange market intermediaries, institutions under the surveillance of the Banking Superintendency, which assumed greater responsibilities. Financial intermediaries in Colombia, all of which abide by international regulations, are required to identify those persons that carry out operations in the so-called free markets involving sums over US$ 10,000. In addition, the Board of Directors of the Central Bank adopted special controls and registration requirements for the reimbursement of tourism and services transactions.

The recent trends of exchange-rate appreciation can be explained by factors quite different from drug trafficking. An external boom is imminent, as a result of the Cusiana and Cupiagua oil discoveries. Hence, expectations of large foreign-currency inflows, caused by oil sales, growth in other exports and higher coffee prices, have anticipated currency appreciation and led the public to contract debts in foreign currencies and to change portfolio composition in favour of assets in local currency. This is consistent with the world-wide trend of increasing foreign-direct investment in developing countries, particularly in Latin America.

Nevertheless and contrary to what is suggested by the figures presented in the DEA report (it claims that in 1994, foreign-exchange reserves will increase to almost US$ 800 million), Colombia's international reserves are not expected to increase. This is particularly interesting in view of the significant increase in international coffee prices, which have generated additional exports of over $1 billion.

In any case, Colombian authorities have themselves expressed their concern at the excess of foreign-currency reserves and the resulting pressure on appreciation of the Colombian peso. This situation, which appeared at the beginning of the present decade, has resulted from factors other than drug trafficking and money laundering, even though these elements certainly act in the same direction. In this sense, the DEA report is correct in pointing out that the effects of incomes coming from narcotics are negative, in the long run, for the Colombian economy. However, the negative effects of such income have been felt for more than two or three decades, since drug trafficking appeared on the Colombian scene: they do not constitute a new phenomenon caused by economic policy reforms, nor have they been aggravated by those reforms.

B. Foreign investment

Foreign investment in Colombia was fostered with the expedition of the International Investment Statute. b/ Foreign investment has increased at a spectacular rate in the last year, mainly in the oil sector, as a result of Ecopetrol's association with the British Petroleum Company and other international oil companies for the development of the Cusiana and Cupiagua oil fields, as well as in the telecommunications sector, due to the implementation of cellular telephone systems, which are currently being installed. The decision to support foreign investment and treat foreign investors on an equal footing with Colombians was a decision taken by the Gaviria Administration that the Samper Administration supports and maintains. Therefore, the DEA suggestion that the increase in foreign-direct investment in Colombia in recent years has its origins in drug money has no empirical basis whatsoever. In addition, that suggestion disregards the substantial resources invested by major British, American and other foreign companies in the development of productive activities in Colombia.

C. Inflation

It is not true that a 25 per cent inflation is associated with drug phenomena: the average inflation rate in Colombia over the past 20 years has been close to that figure. Colombia is a unique case in Latin America, a country in which moderate and persistent inflation has attracted the attention of important national and international analysts who have been able to provide sound macroeconomic explanations for that inflation; such experts have never resorted to the explanation contained in the DEA report.

D. Government financing

It is suggested in the DEA report that the Government of Colombia has been able to finance itself with drug-trafficking money in order to meet its expenses and contribute to the development of the country's infrastructure.

This statement is totally false. To assert that the Government obtains financial resources from drug trafficking is to ignore the significant revenue efforts made by the nation in recent years through fiscal reform, a well as the obvious fact that drug traffickers do not file their incomes, nor do they pay taxes. It is thanks to contractionary fiscal policies and not to the alleged financing of drug trafficking that the consolidated public sector has been in equilibrium or in surplus in recent years, allowing the Government to reduce the remainder of the country's external debt and make prepayments of acquired undertakings with international banks. In fact, in its fight against the drug cartels, the Government has had to divert significant resources from key sectors, such as education, health and transport, to the detriment of the poor and the overall competitiveness of the economy.

E. Construction boom

The construction sector, which had a 3.18 per cent share in the gross domestic product in 1993, has grown at an annual average rate of more than 10 per cent in the last two years, becoming one of the most dynamic sectors in this period and stimulating the growth of other industries and sectors. This growth has been financed by a significant increase in credits made by savings and loans corporations and credit institutions that specialize in mortgage credits; their loans had a 53.7 per cent annual nominal increase, equivalent to a 25.4 per cent real increase between 1992 and 1993.

In 1993, savings and loans corporations obtained 4.045 billion Colombian pesos (Col$) in constant value savings accounts and savings deposits. Their asset increase during the 1992-1993 period reached a 42.4 per cent average growth. Such deposits were not highly concentrated: in December 1993, assets were composed of 185,000 accounts in term deposit certificates, 6 million savings accounts and 2.3 million regular deposits. The average account size rose to Col$ 539,000.

It follows, then, that the construction boom is not the result of the investment of drug-trafficking profits, as suggested by the DEA report, but of the expansion of aggregate demand, induced to a good extent by macroeconomic conditions of abundant liquidity and lower domestic interest rates than those prevailing during the 1980s.

II. REFORM OF THE FINANCIAL SECTOR AND PRIVATIZATION OF GOVERNMENT-OWNED FINANCIAL INSTITUTIONS

A. Modernization of the financial sector and money laundering

The purpose of the financial reform initiated in 1990 was to increase the efficiency of the financial sector and the way in which financial transactions were carried out. Generally speaking, the final beneficiary of this reform is the common client.

Beneficial modernization processes cannot be obstructed on the grounds that they can be used by drug traffickers: this would be like closing car factories throughout the world to prevent thieves from driving getaway cars after robberies. The DEA report reaches this absurd conclusion, criticizing the fact that coverage mechanisms are being developed in the financial and foreign-exchange markets in Colombia that drug traffickers could use in the long run.

The financial system's organic statute establishes controls for the prevention of illegal activities (art. 102) and restricts cash transactions in excess of Col$ 7,500,000 (art. 103). It would be nonsense, however, to restrict the development of financial products that are widely used throughout the rest of the world on the grounds that they could be used for the handling of illegal money.

The liberalization of the financial system and the modernization process have never facilitated money laundering. On the contrary, through its implementation the Government has induced financial institutions to get to know their customers better and undertake a specific and direct surveillance of transactions in order to prevent their being used as instruments for the illegal concealment, handling, investment or use of money or other goods coming not only from drug-trafficking activities but from any other kind of criminal activity.

The regulatory framework in this area encompasses a wider field of action than money laundering: financial institutions that fail to enforce it are subject to both administrative and criminal sanctions. Moreover, under Colombian law banking secrecy does not constitute any obstacle whatsoever for the investigation of offenses with a prior judicial warrant.

The financial system requires that financial institutions provide the information demanded by the Government Attorney's Office and must, when necessary, informally waive banking secrecy in order to report to the Attorney's Office and must, when necessary, informally waive banking secrecy in order to report to the Attorney's Office relevant information on the handling of funds, including any amounts and characteristics of transactions that are not consistent with their customers' economic activities.

In addition, institutions must report transactions the amount or particular characteristics of which may reasonably suggest that they are being used for the transfer, handling or investment of resources coming from criminal activities (arts. 102 through 107 of the financial system's organic statute). Since the privatization of the financial sector, a norm has been included in law 74 of 1979 to verify the moral suitability of the parties and the origin of their properties. All of these measures support Colombia's ratification of the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

B. Privatization of financial institutions

The privatization of financial institutions has been carried out following norms and with the approval of potential buyers by the Banking Superintendency concerning their suitability, responsibility and nature. The process has been conducted in this way in all cases: no institution has been purchased by persons involved in drug trafficking.

All purchase of government-owned financial institution shares within a percentage point of, equal to or larger than 5 per cent required the authorization of the Banking Superintendency. Similarly, all incorporation processes of an institution or negotiations of over 10 per cent of their value require such authorization.

For accreditation and authorization purposes, the Superintendency makes a careful study of their suitability, responsibility and character of the persons interested in purchasing shares in financial institutions, verifying the source of origin of their resources in such a way that money coming from illegal activities is prevented from entering into the financial system. The penalty

for omitting this authorization is the ipso facto declaration of nullity of the transaction without the need for a judicial statement (arts. 58, 88 and 305 of the financial system's organic statute). In all cases, a prior review is made, and there is evidence that the participation of criminal elements has been prevented, as was the case with the Banco de los Trabajadores and the Banco de Caldas.

It would be a disservice to the Government of Colombia if the DEA had serious evidence of the involvement of drug money in the privatization of the banking system but did not provide such evidence to aid Colombian authorities in the struggle against drug trafficking, which the country is waging with little international support.

III. COMMERCIAL LIBERALIZATION, ECONOMIC INTEGRATION WITH VENEZUELA AND PRIVATIZATION OF MARITIME PORTS

A. Commercial liberalization and the rise in consumer demand

Colombia has eased financial and business transactions within its economic openness and modernization processes in order to increase the volume of foreign trade and reduce the costs of international transactions. Colombia wishes to compete with developed countries in international markets. The accusation that this process facilitates drug traffickers' operations is applicable to any country in the world, including the United States of America.

The DEA report contains no empirical evidence that the liberalization process has facilitated drug-trafficking operations. Therefore, its claims remain vague possibilities that must be stated in greater detail if individual measures are to be taken to prevent any such facilitation from occurring.

Regarding economic integration between Colombia and Venezuela, it is clear that such trade openness increases the demand for consumer and luxury goods. Colombia had been lagging in the number of cars per inhabitant in relation to its per capita income; this was explained by a deliberate policy of restricting car trade through high customs duties, among others. The increase in demand for consumer goods, particularly cars, was an obvious result of the liberalization process, greater liquidity and low interest rates that have characterized the Colombian economy in recent years. Accordingly, this increase cannot be explained as a consequence of a generalized and massive laundering of assets originating from drug trafficking.

B. Privatization of maritime ports

The DEA report confuses the privatization of maritime ports with customs control. It asserts that the privatization of ports shield drug traffickers from all but a minimal control by customs, and also considers the possibility that customs control could disappear. However, these are two radically different issues. The fact that the private sector operates the ports of Colombia, as is the case in many other countries, does not mean that the

Government is excused from its customs responsibility and that the illegal smuggling of drugs or imported goods will be thereby placed beyond its control. On the contrary, the Government of Colombia is making rapid progress in strengthening its customs operations.

IV. CONCLUSION

In the light of the arguments presented above, the Government of Colombia requests an immediate clarification and reassessment of this topic by the United States Drug Enforcement Agency. The Government of Colombia also requests that any such clarification be made public or at least benefit from the same coverage as the report published by the DEA.

In addition, in order to preserve the good and cooperative relationship that has traditionally existed between itself and the DEA the Government of Colombia requests that future reports and investigations made by the DEA be based on more scientific methods and information, and that in the future greater efforts be made by the DEA to ensure accuracy when analysing problems related to Colombia.

The control of money-laundering activities is one of Colombia's priorities. That is why Colombia is promoting a series of technical meetings and international consultations to design a set of specific guidelines as the cornerstone of a global treaty to stop money laundering across international borders. The summit of the Americas should be the starting-point for such an initiative and Colombia will therefore encourage the adoption of such a treaty by all the countries of the western hemisphere by 1996.

Notes

a/ Calvo, Leiderman and Reinhart, Capital Inflows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors (Washington, D.C., International Monetary Fund, 1992).

b/ CONPES resolution 51 of 1991.

Appendix

APPROXIMATE DISTRIBUTION OF DRUG-TRAFFICKING PROFITS

It has been estimated that the network of cocaine production and distribution at the end of the last decade suggested the following distribution of profits from the sale of one kilogram of cocaine:

	United States dollars
Retailers a/ in the United States of America	1 000 000
Wholesalers in the United States of America	40 000
Importers in Miami	20 000
Exporters in Colombia	7 000
Producers	1 000

Source: Marcos Kaplan, Sociopolitical Aspects of Drug Trafficking (Mexico City, National Criminal Science Institute, 1990).

a/ Selling by the gram.

Although these are approximate figures, they give some idea of the sums of money that are handled in this business in the different phases of the production-consumption network.